Statement of the
Multistate Tax Commission
on
S. 1755
the
Mobile Telecommunications Sourcing Act of 1999
before the
United States Senate
Commerce, Science and Transportation Committee

March 7, 2000

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Appendix A – Multistate Tax Commission Resolution Supporting S. 1755

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I. The Multistate Tax Commission. The Multistate Tax Commission is an organization of state governments that works with taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Created by an interstate compact, the Commission:

> encourages tax practices that reduce administrative costs for taxpayers and States alike;
>
> develops and recommends uniform laws and regulations that promote proper state taxation of multistate and multinational enterprises;
>
> encourages proper business compliance with state tax laws through education, negotiation and compliance activities; and
>
> protects state fiscal authority in Congress and the courts.

Forty-four States (including the District of Columbia) participate in various programs of the Commission.

Mobile telecommunications have transformed our way of life. In the present day, it is common, sometimes preferred, to conduct business or converse with friends and family on a wireless telephone while moving about the city, the state, the country, or the world. This new mobility presents challenges for consumers, telecommunications service providers, and, in particular, local, state, and federal governments that must regulate both the service and use of mobile telecommunications.

S. 1755, the Mobile Telecommunications Sourcing Act of 1999 is the product of several years of earnest negotiations between the states and telecommunications providers to resolve the difficult issue of providing a uniform rule for determining the location of mobile telecommunications services and assigning a taxing jurisdiction to those services. This effort is unique. Rarely, have states and industry collaborated in this manner. The result of this effort has produced a dramatic simplification in telecommunications taxes that protects consumers, streamlines tax reporting mechanisms for telecommunications providers, and prevents potential double tax assessments by states upon consumers. Most importantly for states and localities, S. 1755 preserves their sovereignty and taxing authority over state and local telecommunications tax structures.

The Multistate Tax Commission is pleased to offer its support for S. 1755. A copy of the Commission's resolution supporting this legislation is attached to this statement.

II. The Proposal. In practical and general terms, S. 1755, the Mobile Telecommunications Sourcing Act (the "Act") provides a uniform rule for determining the location of the sale and purchase of mobile telecommunications (wireless) services when that determination is necessary for the proper application of a state or local tax. The uniform rule of the proposal is that only the taxing jurisdiction or jurisdictions may impose the telecommunications taxes covered by the proposal whose territorial limits encompass the wireless customer's place of primary use. This defined location in practical effect establishes where the sale and purchase subject to the state or local tax is occurring. The uniform rule also necessarily identifies the taxing jurisdictions that may impose a tax collection and/or payment obligation and the wireless providers to which the obligation pertains.

III. Reasons for the Proposal. States and localities impose transactional taxes, like sales and use taxes, on the provision of mobile telecommunications services. A transactional tax for these purposes is a tax that necessarily requires a determination of where the services are sold and purchased in order to apply the taxes applicable to that location. It can be difficult to determine the precise location of the sale and purchase of wireless services. Consequently, it can also be difficult to determine the precise taxes that are applicable to the provision of wireless services.

Difficulty in determining the precise location can arise from the mobile character of the services. Thus, for example, a wireless call can come from and go to any location and the location can even change during the course of the call. Further, wireless companies offer billing plans that significantly reduce at the retail level the business need to identify the precise location of the retail sale and purchase. One example of this trend is a nationwide subscription plan that permits wireless calling without roaming charges or long-distance charges from any location, provided a certain specified number of minutes of use per month is not exceeded.

It can also be difficult to determine all the taxes that are applicable to the precise location where a wireless call is sold and purchased. This difficulty can arise from having to match correctly each identified location to the boundaries of the various local taxing jurisdictions in a State that permits local taxation of wireless telecommunications.

Given these and other practical difficulties, the wireless industry sought development of taxing systems that lessened the burden of having to determine the location of the sale and purchase of *each* wireless call and the taxes applicable to *each* call. This effort captured the attention of state and local tax administrators who desire to have existing tax systems better match current business practices and reality. Representatives of the wireless industry and state and local tax administrators jointly developed the proposed Mobile Telecommunications Sourcing Act (July 21, 1999, version) (the "Act").

IV. Conceptual Structure of Proposal.

(1) Taxes Subject to Act—This remedial legislation is applicable only to a limited set of state and local taxes for which the demands of sourcing require amelioration. The taxes that come within the scope of the Act are those for which it is necessary to determine the location of the sale and purchase of mobile telecommunications services in order to apply the tax.

(2) Sourcing—The Act eliminates the need to determine the precise location of the sale and purchase of mobile telecommunications services where charges are billed by or for the wireless provider with which the customer contracts for services. In place of locating the sale and purchase, the Act provides that wireless calls will be located for tax purposes in the jurisdiction(s)

There may be more than a single jurisdiction, because in some States telecommunications taxes coming within the terms of the proposal are imposed by local jurisdictions.

of the customer's *place of primary use*. Place of primary use for these purposes means either the customer's residence or primary business location that is within the licensed service area of the wireless provider with which the customer contracts for wireless services. Limiting a place of primary use to one of these two choices minimizes the opportunity for tax planning that could occur through the selection of a taxing situs solely for its tax climate.

In implementing this sourcing rule, the Act contains both a congressional authorization and prohibition. First, the Act *authorizes* States and localities to apply their taxes to wireless telecommunications on the basis of the place of primary use concept regardless of the origination, termination, or passage of the telecommunications being taxed. Second, the Act *prohibits* any other State and locality from taxing the telecommunications.

(3) Identification of Tax Jurisdiction(s)—Additionally, the Act provides that a State can elect, from time to time, to make a database available to wireless providers that would match a specific street address to the applicable taxing jurisdiction(s). This match would then permit wireless providers to determine the applicable taxes of the jurisdiction(s). If the wireless provider uses a database provided by a State, the State may not assess the provider for taxes not paid as a result of errors or omissions in the database. Alternatively, if a State elects not to provide the database, the provider may use an enhanced zip code (zip + 4 or a zip of more than nine digits) matching system to determine the applicable taxing jurisdiction(s). A provider may not be assessed for taxes not paid under the enhanced zip system as long as the provider uses due diligence in completing the match.

(4) Nonseverability Clause—The Act provides that if subsequent litigation determines that the Act violates federal law or the Constitution or that federal law or the Constitution substantially impairs the Act, the entire Act falls. This nonseverability is a critical feature of the Act, because the States are giving up an existing state tax system with one set of jurisdictional understandings in favor of a different taxing system with a different jurisdictional understanding. Without that clause, the legislation could create an incentive for litigation that would, unfortunately, seek to convert this legislation from being of mutual benefit to states, localities and the industry to legislation that would, in fact, preempt state taxing authority and undermine state sovereignty. If the new system is lost, the States want an unrestricted ability to return to the *status quo ante*.

V. <u>Outline of Provisions</u>. The provisions of the Act are as follows—

A. The findings of *Sec. 2* describe the problem of applying state and local transactional taxes to wireless telecommunications and the competing value of preserving viable state and local governments in our federal system. The findings also acknowledge the need for a practical solution in the area of state and local taxation of mobile telecommunications services.

A. *Sec. 3* directs classification of the provisions of the Act to a position in title 47, United States Code. Thus, title 47 is amended by adding new Sec. 801 thru 812 with provisions as follows:

1. *Sec. 801(a)* describes the taxes subject to the sourcing rules of the Act. By definition of inclusion and exclusion the affected taxes are limited to transactional taxes where it is necessary to identify the location of the sale and purchase of the mobile telecommunications services.

1. *Sec. 801(b)* excludes the applicability of the Act to certain specified taxes. The exclusion means that the Act applies to taxes whose application is dependent upon locating the place of sale and purchase of wireless telecommunications. Taxes excluded from the Act include, among others, income taxes and taxes on an equitably apportioned gross or net amount that is not determined on a transactional basis.

1. *Sec.801(c)(1)* provides that the place of primary use sourcing rule of the Act does not apply to prepaid telephone calling services. See Sec. 3(m)(8) that defines these services.
1. *Sec. 801(c)(2)* clarifies the application of the provision in the Act that resellers are not customers when the Internet Tax Freedom Act (Title XI of Pub. L. 105-277) precludes taxability of either a sale or resale of mobile telecommunications services. If the Internet Tax Freedom Act prohibits taxation of either the sale or resale, a State is not restricted under the Act from taxing the sale (in case of a restriction against taxation of the resale) or the resale (in the case of a restriction against taxation of the sale) wireless telecommunications services.
1. *Sec. 801(c)(3)* provides that the place of primary use sourcing rule of the Act does not apply to air-ground radiotelephone service as defined in 47 C.F.R. §22.99 as of June 1, 1999.
1. *Sec. 802* establishes the rule of taxation that wireless telecommunications are taxable by jurisdiction(s) in which the place of primary use is located. The rule only applies to charges for wireless services for which charges are billed by or for the wireless provider with which the customer contracts. See Sec. 809(5).
1. *Sec .802(b)* authorizes States and localities to impose taxes based upon the place of primary use and prohibits them from imposing taxes on a different basis.
1. *Sec. 803* limits the effect of the Act to its express terms.
2. *Sec. 804* allows a State or a designated database provider to make a database available in a uniform format. The database will match street addresses (in standard postal format) within the State to the applicable taxing jurisdictions. A wireless provider using the database is generally protected against assessment for errors or omissions in the database.
1. *Sec. 805(a)* authorizes a wireless provider to use a system that matches enhanced zip codes (zip + 4 or zip codes of more than nine digits) to the applicable taxing jurisdictions, when a State elects not to provide the database described in Sec. 804. Specified conventions apply to the use of the enhanced zip system. A wireless provider is protected against assessment for an erroneous matching of a street address to the applicable taxing jurisdiction(s) where the provider can show it exercised due diligence.
1. *Sec. 805(b)* continues the qualified protection against assessment for wireless providers that are using the enhanced zip system for a defined transitional period following the taxing State's provision of a database that meets the requirements of Sec. 804.
1. *Sec. 806(a)* provides that a taxing jurisdiction under specified procedures can require (through an audit-like action after meeting certain standards) a wireless provider to change prospectively the customer's place of primary use or require the wireless provider to change prospectively the applicable taxing jurisdiction(s). The affected customer or the wireless provider is afforded the opportunity of administrative review, if desired.
1. *Sec. 807(a)* notes that initial designation of the place of primary use is principally the responsibility of the customer. A customer's designation is subject to possible audit. See Sec. 806(a) discussed above. *Sec. 806(a)(2)* states that, with respect to taxes customarily itemized and passed through on the customer's bills, the wireless provider is not generally responsible for taxes subsequently determined to have been sourced in error. However, these rules are subject to the wireless provider's obligation of good faith.
1. *Sec. 806(b)* provides that in the case of a contract existing prior to the effective date of the Act a wireless provider may rely on its previous determination of the applicable taxing jurisdiction(s) for the remainder of the contract, excluding extensions or renewals of the contract.
1. *Sec .808(a)* contemplates that a taxing jurisdiction may proceed, if authorized by its law, to

collect unpaid taxes from a customer not supplying a place of primary use that meets the requirements of the Act.

1. *Sec. 808(b)* states that a wireless provider must treat charges that reflect a bundled product, only part of which is taxable, as fully taxable, unless reasonable identification of the non-taxable charges is possible from the wireless provider's business records kept in the regular course of business.

1. *Sec. 808(c)* limits non-taxability of wireless telecommunications in a jurisdiction where wireless services are not taxable. A customer must treat charges as taxable unless the wireless provider separately states the non-taxable charges or provides verifiable data from its business records kept in the regular course of business that reasonably identifies the non-taxable charges.

1. *Section 809* defines the terms of art of the Act:
   - *Sec. 809(1)* defines "charges for mobile telecommunications services".
   - *Sec. 809(2)* defines "taxing jurisdiction."
   - *Sec. 809(3)* defines "place of primary use" as the customer's business or residential street address in the licensed service area of the wireless provider. Place of primary use is used to determine the taxing jurisdiction(s) that may tax the provision of mobile telecommunications services. If a wireless provider has a national or regional service area, like a satellite provider, the place of primary use is still limited to the customer's business or residential street address within that larger service area.
   - *Sec. 809(4)* defines "licensed service area."
   - *Sec. 809(5)* defines "home service provider."
   - *Sec. 809(6)* defines "customer." Under a special rule, customers include employees (the end users) of businesses that contract for mobile telecommunications services. Customers do not include (i) resellers, except resellers where the Internet Tax Freedom Act would prohibit taxation of wireless services sold by a reseller (see item Q, above); and (ii) a serving carrier providing wireless services for a customer who is outside the customer's contractual provider's licensed service area.
   - *Sec. 809(8)* defines "prepaid telephone calling services."
   - *Sec. 809(9)* defines "reseller." A reseller does not include a serving carrier providing wireless services for a customer who is outside the customer's contractual provider's licensed service area.
   - *Sec. 809(10)* defines " serving carrier."
   - *Sec. 809(7)* defines "designated database provider."
   - *Sec. 809(11)* defines "mobile telecommunications services" as commercial mobile radio service as defined in 47 C.F.R. §20.3 as of June 1, 1999. This definition includes wireless services that are furnished by a satellite provider.
   - *Sec. 809(12)* defines "enhanced zip code," a term that refers to zip +4 or a zip code exceeding nine digits.

2. Sec. 810 negates FCC jurisdiction over the Act, thereby avoiding the anomalous circumstance of a non-elected federal regulatory body having administrative responsibility over a provision going to the core of state sovereignty in our federal system of government.

1. *Sec. 811* expressly provides for nonseverability in the event of a judicial determination that the

Act is unconstitutional or otherwise substantially impaired from accomplishing its objective.

C. *Sec. 4* establishes an effective date of the first month following two years after enactment. The transitional delay allows both business and tax administrators to gear up for a change in their existing systems, including the possible use of the database authorized by Sec.804.

VI. <u>Legal Issues</u>. *(1) Constitutionality*—In *Goldberg* v. *Sweet*, 488 U.S. 252, 263 (1989), the U.S. Supreme Court explained what States had jurisdiction to apply a transactional tax to interstate telecommunications. Jurisdiction rested with the State or States from which the telecommunications originated or in which the telecommunications terminated, provided that that State also was the State of the service address (address of the equipment to which the telecommunications was charged) or the billing address. The Supreme Court has not generally denied the possibility of jurisdiction in other States, except that the Court has specifically noted a State through which the telecommunications passes or in which the telecommunications terminates lacks sufficient contacts to tax the telecommunications. See 488 U.S. at 263.

The *place of primary use* rule provided in the Act does not follow the prescription of *Goldberg* v. *Sweet*. Some may question therefore whether a State (or a local jurisdiction of a State) of the place of primary use has sufficient basis for asserting jurisdiction to impose a transactional tax in all instances contemplated by the Act. This alleged deficiency is best illustrated by the taxation of a mobile telecommunications event occurring in two States, neither of which is the State of the place of primary use, e.g., a subscriber of mobile telecommunications services in the State of A, travels to State B and places a wireless call to a location in State C. Under the Act, State A would be the only State with authority to tax this call.

The justification for permitting State A to tax the illustrated call is that State A is the State in which the contractual relationship is established that in effect sponsors the customer to make the State B to State C call. Clearly State A has a significant contact with the provision of mobile telecommunications services, no matter where the call is made. State A's contact is especially compelling support of jurisdiction, if the call is made pursuant to the provider's wireless plan that allows the subscriber to make the call that involves other States utilizing the provider's own system, but in separate licensed service areas. Similarly, State A would have strong contact where the provider's billing plan is a flat rate plan that generally ignores the location from which calls are made as long as certain time limits are not exceeded. In this latter case, the provider could be characterized as selling wireless access and not selling specific mobile telecommunications events.

But even without these kinds of strong contacts, as where the call originating in State B and terminating in State C incurs roaming and/or long-distance charges; State A's connection to the call is nevertheless substantial. It is the subscriber's existing contractual relationship to the State A provider that allows the subscriber to enter the wireless system to make, and incur charges related to, the State B to State C call. That kind of connection seems more than sufficient to support State A's jurisdiction to tax the call, even though it does not meet the origination/termination and service/billing address rule of *Goldberg* v. *Sweet*.

Yet this faith in the jurisdiction of State A is unproven. And one must face the prospect that a constitutional challenge may be mounted under the Due Process Clause and the Commerce Clause against allowing State A to tax the call. One would suppose a challenge under the Commerce Clause would be easily rebuffed, since Congress can consent to state taxation that would otherwise violate the Commerce Clause. *Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408, 434 (1946). The harder question is whether Congress can consent to state taxation that would otherwise violate the Due Process Clause. Thus, to the extent the *Goldberg* v. *Sweet* rule is grounded in the jurisprudence of the Due Process Clause, something a close reading of the Supreme Court cases does not clearly disclose, this other question must be answered. The States and local governments and congressional legislators will want to weigh, before enactment of the Mobile Telecommunications Sourcing Act, the strength of the alternative argument that a congressionally authorized plan of taxation overcomes Due Process Clause objections in certain circumstances.

Scholars have addressed the question about congressional power to override Due Process Clause restrictions on state power. William Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 Stan. L. Rev. 387 (1983); William Cohen, *Congressional Power to Interpret Due Process and Equal Protection*, 27 Stan. L. Rev. 603 (1975); Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 Tax L. Rev. 425 (1997). The consensus seems to be that Congress' power to consent to state violations otherwise occurring under the Due Process Clause does not extend to violations of individual rights but does extend to violations arising out of our federal form of government. Any other conclusion would place our federal form of government at the mercy of requiring a constitutional amendment to cure issues of federalism that could otherwise be solved by congressional adoption of practical solutions to intractable problems. Institutionally speaking, this kind of outcome from the U.S. Supreme Court is a rare result reserved for only the most fundamental of issues arising under our Constitution. State and local taxation of wireless telecommunications under a congressionally-sanctioned, practical convention sought by the industry to solve an intractable problem and developed cooperatively with governmental assistance hardly falls into that category.

To prevent the legislation from creating an incentive for litigation, the Act contains a nonseverability provision. Act Sec. 3(b). This provision ensures that if the congressionally-sanctioned, practical convention fails so will the newly established restrictions that have been placed against state taxing power by the Act. Act Sec. 3(a)(2) (*last clause*). States that conform their law to the new taxing convention of the Act may also provide for a back-up tax that is based upon the assumption of the old taxing system remaining non-operational as long as the new convention remains valid and in effect. A back-up tax of this type will discourage adventuresome litigation to see what might be gained by attacking the constitutionality of the new system.

(2) *Open Mobile Telecommunications Systems*—The solution developed under the Act presupposes a wireless telecommunications infrastructure that operates based upon a contractual relationship between the subscriber and the home service provider that has a license service area for the location of the subscriber's business or residence. While it is never possible to predict where a form of commerce may eventually go, there are indications that wireless communications may eventually become open. An open infrastructure would mean that all one needed for connecting into the wireless channels of telecommunications would be a handset. Billing for use of the wireless channels of telecommunications in an open system would be triggered by actual use based upon information transmitted at the time of the placement of the call.

If an open system eventually develops for the most part, and there is no assurance that it will, the utility of the solution offered by the Act becomes limited. The Act to some extent acknowledges the impracticality of the solution of the Act in an open system by excluding the prepaid calling card system. But the Act's definition of the term prepaid calling services is restrictive enough not to exclude an open system from the operation of the Act. Nevertheless, it would seem an open system by practical necessity is excluded from the operation of the Act. The contractual relationship that is described in the Act's concept of a home service provider would seem to be missing. In addition, on-site billings that are presupposed by an open system would seem to lessen the need for the practical place of primary use solution of the Act. Finally, the coincidence of a residence or an office with the licensed service area of the connecting provider in an open system would seem to be in most instances a rare occurrence. But if an open system is excluded from the operation of the Act, it remains an unanswered question whether it is appropriate for the Act to anticipate an open system in wireless telecommunications and to provide a solution for this possible development also.

(3) Freezing definitions in time—Some key concepts of the Act are frozen in time by legal understandings that exist as of a date certain, June 1, 1999. These concepts are air-ground radiotelephone service and commercial mobile radio service. Freezing central concepts in time has the potential to permit the legislation to lose its practicality. Yet it is also difficult to propose a solution that would work regardless of whither the concepts develop over time. There is no easy answer to the dilemma posed and perhaps the approach of the Act is best. After all, if the Act loses its vitality due to evolutionary or even revolutionary change, both industry and state and local tax administrators are equally faced with the challenge of bringing their respective systems into a synchronous relationship.